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A Review of IMF's $7 billion Bailout Package and its Impact on Stabilization of Pakistan's Economy

Pakistan has turned to the IMF for assistance for the 25th time this year, after the failure of its previous program in 2019 and a deepening economic crisis. The country has been struggling with slow economic growth, rising inflation and worsening poverty. Last year, economic growth dropped to 2.4%, below the population growth rate of 2.6%. The situation was worsened by a large budget deficit and increasing debt, with tax revenues at only 12% of GDP while spending reached around 20%. The energy sector and state-owned enterprises continued to suffer losses, while Pakistan's external accounts came under heavy strain due to weak exports, limited foreign direct investment and high dependence on imports. This led to a near-default scenario in 2023, narrowly averted by an emergency IMF deal that ended earlier this year.

Faced with ongoing macroeconomic challenges and an unresolved balance of payments crisis, Pakistan was compelled to seek another bailout from the IMF. Under the new 37-month, $7 billion Extended Fund Facility, the country has committed to several policy reforms to avoid repeating past mistakes. The focus is on fiscal reforms, including integrating the retail, agriculture and export sectors into the formal income tax system through significant tax hikes and the removal of exemptions. Additionally, federal and provincial governments will establish a new national fiscal pact, transferring responsibilities for health, education, social safety nets and road infrastructure to the provinces. The IMF has also required additional tax measures totaling 3% of GDP, which Pakistan has accepted despite the political challenges of implementing such large tax increases.

The New IMF Program and Pakistan

The new IMF program for Pakistan aims to stabilize the economy, but its effectiveness in promoting long-term growth remains uncertain. While it addresses issues like expanding the tax base and improving government transparency, it overlooks critical structural problems, particularly in government spending. The heavy reliance on domestic borrowing for development and non-development expenditures has led to a growing domestic debt crisis, with interest payments consuming over half of the annual budget. Furthermore, political patronage and challenges in the energy sector complicate matters, as the program focuses on raising energy tariffs without reforming cost structures.

To break the cycle of IMF rescues, Pakistan must address its core economic challenges related to debt sustainability and competitiveness. The IMF projects that interest payments will consume about 68% of tax revenue in FY 2023, with the country potentially needing around $146 billion in external financing from FY 2024 to FY 2029. Debt restructuring should be seriously considered, especially given that significant Chinese debt constitutes over 28% of Pakistan's external public debt. While restructuring domestic debt presents political challenges, it remains feasible.

To prevent recurring balance of payments crises, Pakistan must enhance exports and competitiveness, which requires complex reforms such as improving trade relationships, rationalizing import taxes and broadening the tax base. These reforms may encounter resistance from entrenched business interests, underscoring the necessity for a homegrown economic strategy. Nevertheless, the IMF program could offer a valuable framework for tackling critical issues, including debt restructuring and fostering long-term competitiveness in partnership with the World Bank and Asian Development Bank.

Impact of IMF's Bailout Package on Pakistan's Economic Stabilization

1) Stability in Foreign Exchange Reserves

One immediate impact of the bailout was the injection of much-needed foreign currency into Pakistan's reserves, which had fallen to critically low levels, barely sufficient to cover a few weeks' worth of imports. The prompt disbursement of the initial loan installment of just under $1.1 billion helped bolster reserves and restore some investor and market confidence.

Table 1: Liquid Foreign Exchange Reserves-weekend Level ($ Billion)

	Net Reserves with SBP	Total Liquid FX Reserves
Sept-06, 2024	9.4666	14.7961
Sept-13, 2024	9.5096	14.8265
Sept-20, 2024	9.5336	14.8731
Sept-27, 2024	10.7017	15.9829

[Source: State Bank of Pakistan]

From September 6 to September 27, 2024, net reserves with the SBP increased from $9.4666 billion to $10.7017 billion, an increase of approximately $1.2 billion. During the same period, total liquid FX reserves rose from $14.7961 billion to $15.9829 billion, indicating a steady improvement in reserve levels. This gradual rise in reserves, particularly following the initial loan disbursement, likely contributed to stabilizing the currency and market expectations. A healthier reserve level is essential for meeting Pakistan's import needs and servicing external debt, thereby alleviating immediate pressures on the balance of payments.

2) Stability in Exchange Rate

Before the bailout, Pakistan's currency (PKR) had depreciated significantly, leading to increased import prices, particularly for fuel and essential commodities. The IMF package, combined with tighter monetary policy, offered some stability to the rupee, although exchange rate fluctuations persisted.

Table-2: Daily Exchange Rates - Interbank Closing rate

	PKR/US$		PKR/US$
2-Sep	278.64	16-Sep	278.13
3-Sep	278.70	18-Sep	278.04
4-Sep	278.77	19-Sep	277.91
5-Sep	278.68	20-Sep	277.84
6-Sep	278.57	23-Sep	277.87
9-Sep	278.70	24-Sep	277.8
10-Sep	278.62	25-Sep	277.85
11-Sep	278.54	26-Sep	277.69
12-Sep	278.44	27-Sep	277.64
13-Sep	278.16	30-Sep	277.71

[Source: State Bank of Pakistan]

In the first half of September, the exchange rate fluctuated slightly around 278.6 PKR/USD. This stability can be attributed to the IMF's initial disbursement, which bolstered foreign exchange reserves and alleviated market uncertainty. The PKR began to strengthen gradually in the middle of the month, reaching 277.64 PKR/USD by September 27. This improvement reflects a tightening of monetary policy and enhanced market confidence due to the IMF's support, which helped relieve pressure on the rupee.

3) Controlling rising Inflation

A major concern has been inflation, which surged to record highs due to rising fuel prices and currency depreciation. As part of the bailout, the IMF recommended tightening monetary policy, resulting in a significant increase in interest rates to control inflation. This policy had a mixed impact; while inflationary pressures eased somewhat, they remained elevated due to persistent global price shocks and domestic challenges.

Table 3: General Inflation (%) Month on Month from May to Sept 2024

Period	CPI	SPI	WPI
May-2024	-3.2%	-4.0%	-2.5%
Jun-2024	0.5%	1.3%	0.4%
Jul-2024	2.1%	2.0%	2.3%
Aug-2024	0.4%	-0.3%	0.3%
Sep-2024	-0.5%	0.2%	-1.1%

[Source: Pakistan Bureau of Statistics]

The **Consumer Price Index (CPI)** initially fell to -3.2% in May, indicating some deflationary pressure. However, as the monetary measures took effect, it gradually increased to 2.1% in July, before slightly easing to -0.5% in September. This trend reflects a temporary rise in consumer inflation, followed by stabilization efforts.

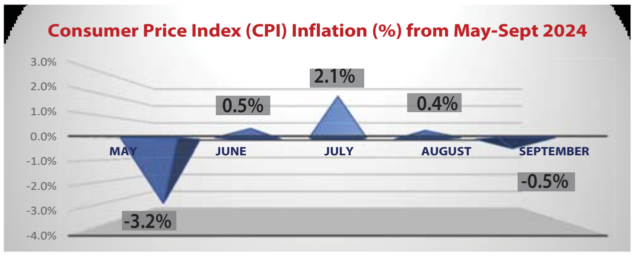

Figure 1: Snapshot of MoM CPI Inflation from May-Sept 2024

The **Sensitive Price Index (SPI)** exhibited high volatility, dropping to -4.0% in May but rising to 2.0% by July, indicating instability in essential commodity prices. By September, it stabilized at 0.2%, reflecting mixed results from the bailout's inflation control measures on sensitive prices.

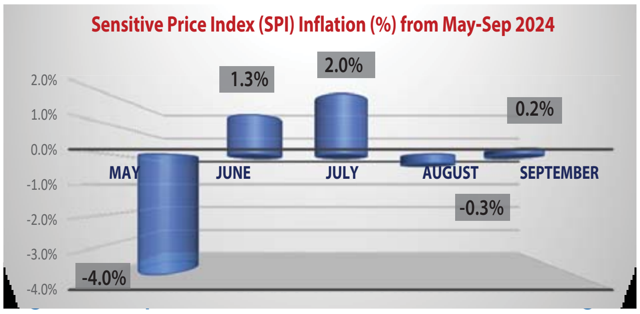

Figure 2: Snapshot of MoM General SPI Inflation from May-Sept 2024

The **Wholesale Price Index (WPI)** displayed a similar volatile pattern, starting at -2.5% in May, peaking at 2.3% in July, and then dropping to -1.1% by September. The spike in July points to inflationary pressures on wholesale prices, while the subsequent decline indicates a potential cooling of wholesale inflation.

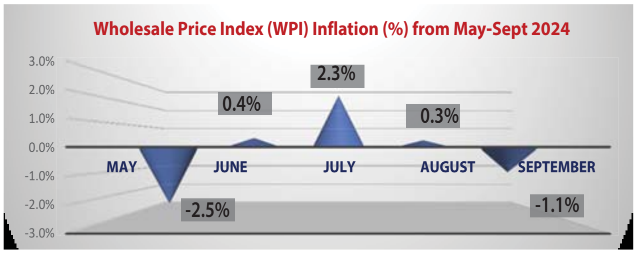

Figure 3: Snapshot of MoM WPI Inflation fromMay-Sept 2024

4) Need for Structural Reforms

The IMF has highlighted the need for structural reforms in tax collection and fiscal policy. The bailout package requires the government to reduce subsidies—especially on energy—and increase tax revenue to achieve fiscal consolidation. While these reforms aim to lower the fiscal deficit, they have led to political controversy, as subsidy cuts and tax hikes typically raise living costs for citizens. In the short term, these measures have resulted in public discontent and increased pressure on the government.

5) Energy Sector Reforms

A significant factor contributing to Pakistan's fiscal challenges is the inefficiency of its energy sector. The IMF has urged reforms in this area, such as tariff rationalization and the reduction of circular debt. Although these reforms are designed to create a more sustainable energy framework, they have led to increased energy prices for consumers.

6) Expanding Social Safety Nets

To mitigate the negative social impacts of economic reforms, the IMF has stressed the importance of expanding social safety nets. While the government has made efforts to provide financial assistance to vulnerable groups, the scale of these programs remains inadequate relative to the population's needs.

Challenges and Criticisms

While the IMF bailout package offers vital support for stabilization, it has also drawn criticism and presents several challenges:

- **Austerity Measures:** The fiscal tightening measures, including cuts to subsidies and increased taxes, have placed additional economic strain on low- and middle-income families, resulting in protests and public unrest.

- **Slower Economic Growth:** The combination of fiscal austerity and tight monetary policy is likely to slow economic growth. While these measures may help control inflation, they can hinder job creation and reduce business activity.

- **Debt Servicing:** With Pakistan's public debt remaining high, the IMF package may address immediate balance of payments issues, but it does little to reduce the country's reliance on external borrowing, which continues to pose a long-term challenge.

Conclusion and Way Forward

The IMF's $7 billion bailout aims to provide immediate relief for Pakistan's balance of payments crisis and help stabilize the economy through important reforms. However, its success depends on the government's ability to handle political resistance to austerity measures, implement structural reforms and protect vulnerable populations.

While the bailout offers short-term support, it cannot fix long-standing problems like tax evasion, corruption and inefficiencies in public sector enterprises that have held back economic growth. For lasting progress, Pakistan needs to improve governance, create a competitive business environment and invest in education and infrastructure. Strengthening institutions is key to building investor confidence and improving access to capital.

Additionally, diversifying exports will reduce reliance on a few sectors and make the economy more resilient to global changes. Ultimately, Pakistan's ability to attract foreign investment, expand its export base, and commit to meaningful institutional changes will determine whether these reforms lead to sustained economic growth and better living standards for its citizens.